

# Discussion of Investment Advisory Services

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## California Debt and Investment Advisory Commission

November 6, 2003

Kay Chandler, CFA

## Topics of Discussion

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- Definition of an Investment Adviser
- Benefits of using an adviser
- Risks
- What to look for
- Fees
- Discretionary vs. non-discretionary
- One adviser vs. multiple advisers
- Summary



## What is an Investment Adviser?

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- An investment firm with demonstrated expertise in the management of investment portfolios
- Acts as a fiduciary for client assets
- Registered with and regulated by the SEC under the Investment Advisers Act of 1940
- Compensated on the basis of assets under management, not transactions



## Benefits of Using an Adviser

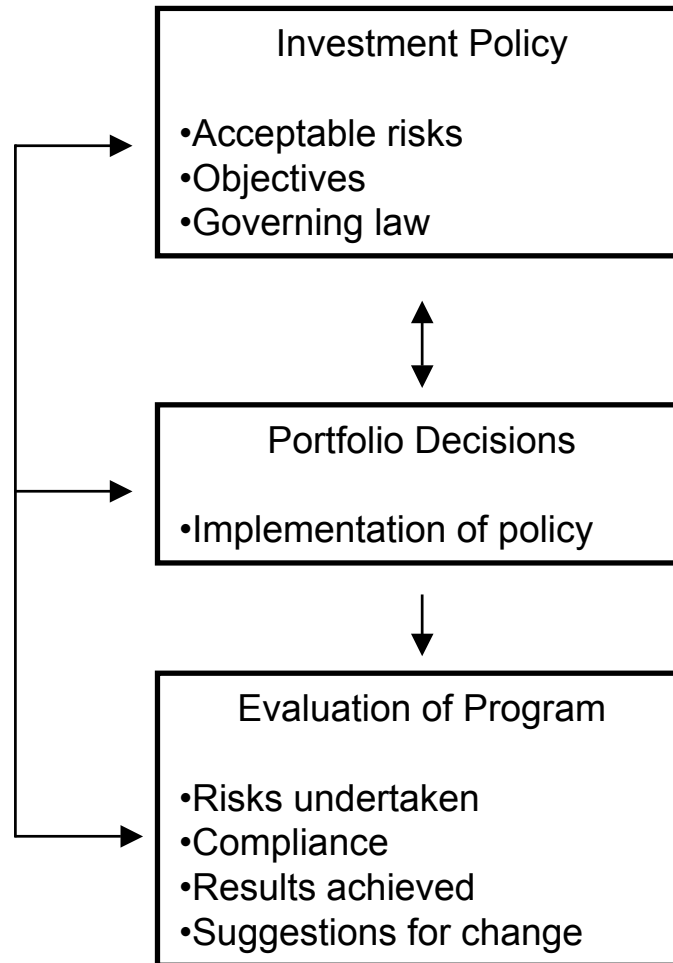
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### ■ Enhanced return

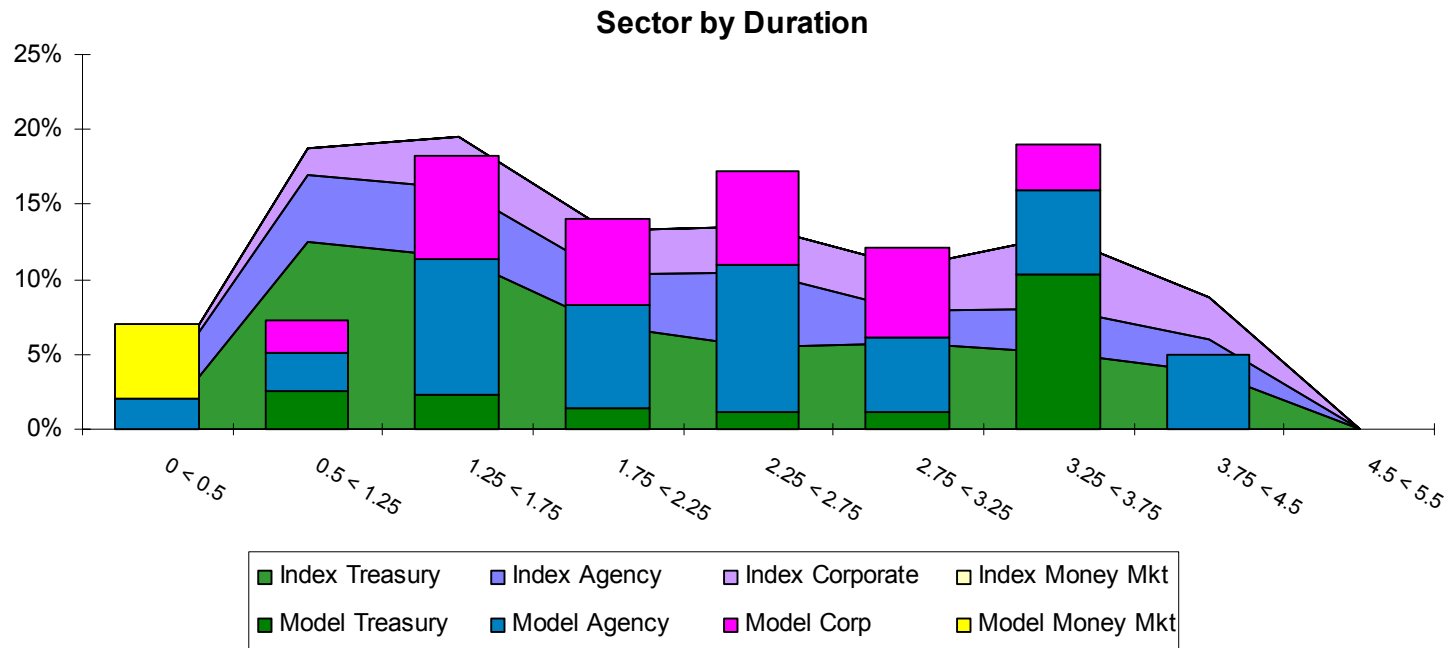
- Emphasis on the *whole portfolio*, rather than individual transactions
- Disciplined investment process employed throughout market cycles result in consistent, predictable returns vs. market benchmarks
- Increased access to dealer inventories of securities to find best prices/least risk alternatives
- Independent, institutional trade execution occurs at better prices



## Emphasis on the Whole Portfolio



## Disciplined Investment Process



## Benefits of Using an Adviser

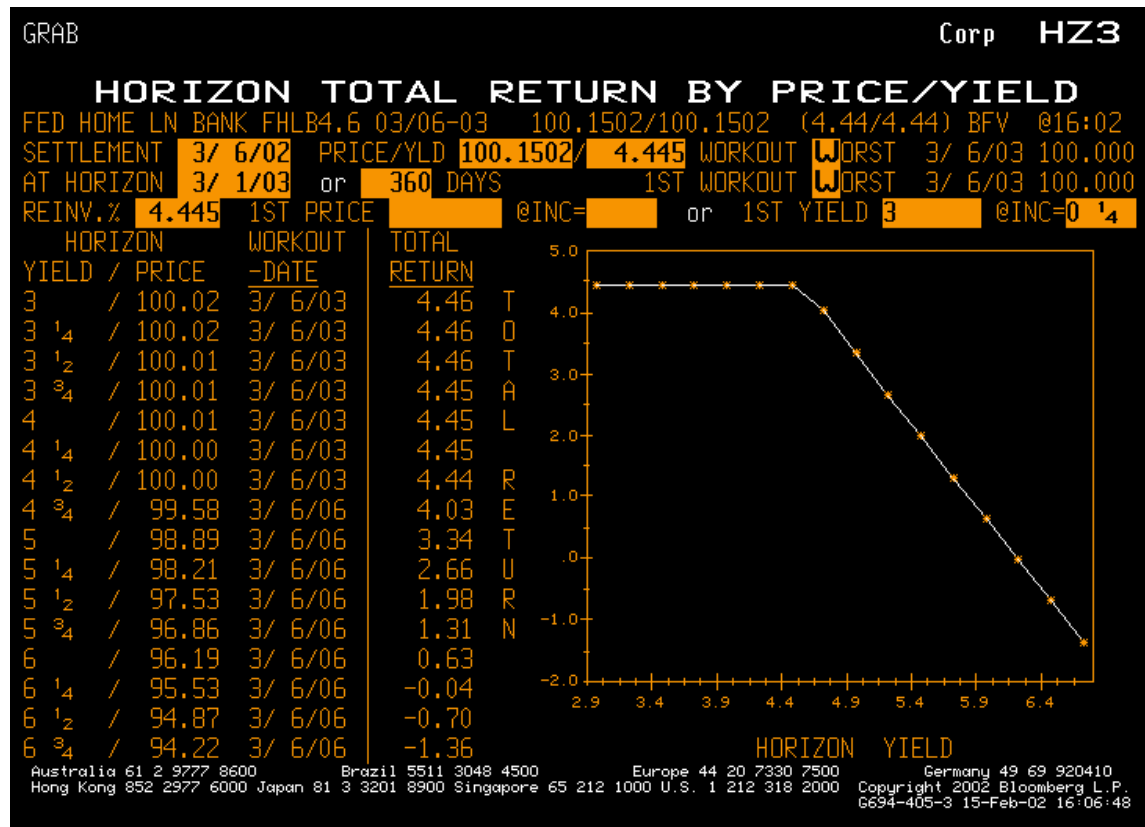
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### ■ Reduced risk

- Rigorous credit monitoring allows for safe use of higher yielding securities (e.g., corporates)
- Advisers' knowledge, experience and access to sophisticated analytic tools leads to understanding of the behavior of complex securities and avoidance of unexpected risk
- Advisers provide consistent approach to investments, even if agency experiences staff turnover/absence
- Advisers have no incentive to initiate transactions unless clearly beneficial for the portfolio



## Analytic Tool From Bloomberg





## Benefits of Using an Adviser

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### ■ Better Information

- Advisers provide comprehensive portfolio accounting and reporting for both management and staff
- Reporting includes analysis/explanations of portfolio performance compared to market benchmarks
- Evaluation of policy compliance in accordance with Government Code requirement for reporting
- Advisers are a resource for understanding economic and market conditions



## Sample Management Summary

Portfolio \_\_\_\_  
 Portfolio Summary Information  
 Period Ending \_\_\_\_\_

**Portfolio Values**

Market Value (including accrued)	\$23,716,493
Amortized Book Value	\$23,305,689
Cost Value	\$22,743,361

**Portfolio Characteristics**

Modified Duration	2.17
Average Maturity	2.44
Average Book Yield	6.50
Average Coupon	6.25
Average Quality	AAA
Average Market YTM	4.89

**Sector/Quality Distribution**

Sector	Market Value	% of Port	Quality
Treasury	\$3,809,486	16.1%	TSY
Agency	\$14,349,352	60.5%	AGY
Corporate	\$5,528,985	23.3%	A
Money Market Fund	\$28,670	0.1%	AAA

**Duration/Maturity Distribution**  
**(% of Portfolio)**

Years	Mod Dur	Maturity
0.0-0.25	2.0%	2.0%
0.25-0.5	3.5%	0.0%
0.5-1.0	10.6%	14.1%
1.0-2.0	16.5%	16.5%
2.0-3.0	49.6%	28.6%
3.0-4.0	17.90%	31.5%
4.0-5.0%	0.00%	7.40%
5.0+	0.00%	0%

**Total Rate of Return**

	Latest Month	Latest 3 Months	Year To Date	Latest 12 Months	Since 3/31/96	Annualized Since 3/31/96
Portfolio	0.15%	1.86%	3.31%	11.36%	39.56%	6.78%
1-5 yr Govt	0.05%	1.64%	2.96%	10.65%	38.26%	6.58%

Pricing Provided by DC

## Sample Compliance Report

**Assets managed by Chandler Asset Management are in full compliance with State law and with the City's investment policy.**

Category	Standard	Comment
Treasury/agency issues	No Limit	Complies
Banker's Acceptances	A1/P1 ;<=40%;270 days	Complies
Commercial Paper	A1/P1;180 days,15% maximum	Complies
Repurchase Agreements	<=90-day; 15% maximum	Complies
Rev. Repo Agreements	<=90-day; 15% maximum	Complies
Negotiable CDs	30%; AAA rated	Complies
Time CDs	25%; 10% per issuer	Complies
Medium Term Notes	30% max; A-rated	Complies
LAIF	Not used by outside adviser	Complies
Mortgage Pass Thrus, including CMOs and ABS	5-year Max. maturity;20% Maximum	Complies
Mutual Funds	Prohibited	Complies
Inverse floaters, range notes	Prohibited	Complies
Interest only strips	Prohibited	Complies
Zero interest accruals	Prohibited	Complies
Per issuer max	5% (except gov'ts)	Complies
Weighted Avg. Maturity	<=3 years	Complies
Maximum maturity	5 years	Complies

## Benefits of Using an Adviser

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- Coordination with internal staff
  - Staff time is freed for other duties
  - There is an important separation of duties between outside manager and staff oversight
  - And the adviser provides the tools for proper oversight



## Are There Any Risks?

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- Third party custodian is essential—an outside adviser should never have custody of assets
  
- The client must monitor
  - Compliance with Government Code
  - Compliance with Policy
  - Performance relative to appropriate benchmarks



## What To Look For in an Adviser

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### ■ Capabilities

- Tenure/qualifications of the investment team
- Investment process
- Longevity of the firm
- Consistent performance history for similar accounts reported in accordance with industry standards



## AIMR Standard Performance Reporting

### ■ The Industry Standard

- Time-weighted total rate of return, including realized and unrealized gains and losses
- Compared to appropriate benchmark
- Including measures of risk
- Extensive footnotes regarding the calculations and the firm

## What To Look For in an Adviser

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### ■ Service

- Quality of reports
- Willingness to tailor services and reports to agency's needs and preferences
- Experience with like agencies
- Compatibility working with the adviser's staff
- References from current clients





## What To Look For in an Adviser

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### ■ Professionalism

#### ■ Designation as Chartered Financial Analyst

- Graduate-level program specific to investment professionals
- Comprehensive knowledge base in investment analysis and portfolio management
- Code of Ethics and Standards of Professional Conduct
- Performance presentation standards



## Investment Advisory Fees

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- Should be no more than 0.15 of 1% (15 basis points), or \$15,000 for every \$10 million under management
- Enhanced earnings should more than offset the fees
- Third party custodian costs are in addition to adviser's fees



## Discretionary vs. Non-Discretionary

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### ■ Discretionary

- Decisions based on Policy and Guidelines
- Better accountability of manager
- Less day-to-day staff involvement
- Greater benefit from manager's process

### ■ Non-Discretionary

- Permission needed prior to trading
- More direct control over manager
- More day-to-day staff involvement
- May miss some benefit if timely permission not received

## One Adviser or More?

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### ■ One Adviser

- Consolidated Reporting
- Lower fee
- Less staff time for monitoring

### ■ Multiple Advisers

- Diversified styles
- Competition between advisers
- More interaction required

## Why Have An Investment Adviser?

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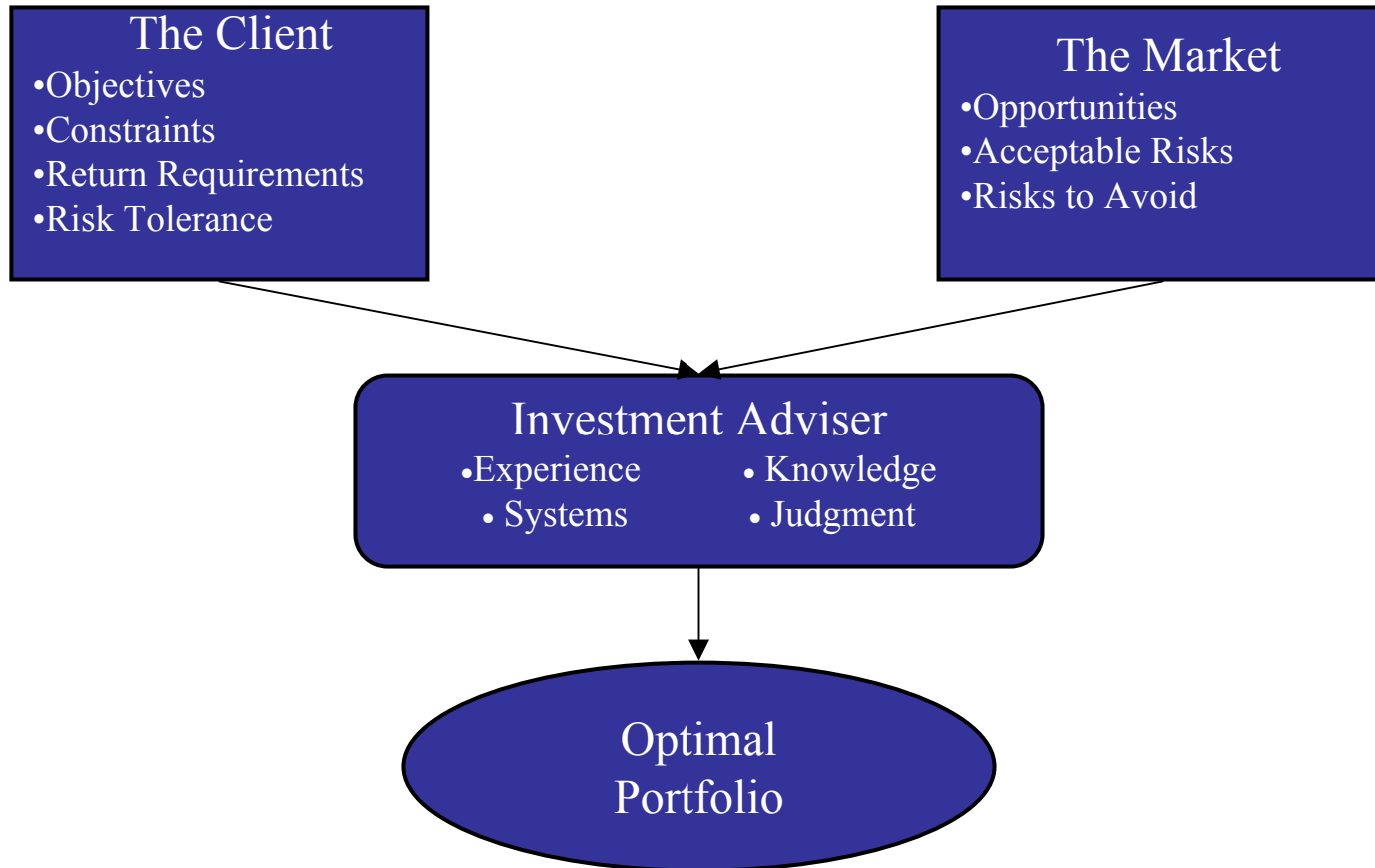
- Expertise
- Experience
- Information
- Analytic Tools
- Defined, Disciplined Process
- Collaboration with Staff to Maximize Internal Resources



# CHANDLER

## The Adviser Intermediates Between The Client and The Market

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**CDIAC**

**INVESTING PUBLIC FUNDS**

**BROKER – DEALERS**

**ROLES AND RESPONSIBILITIES**

**NOVEMBER 6, 2003**

**TONY GARCIA, CFA**

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# BROKER/DEALER?

- Brokers And Dealers
- Primary Dealers And Regional Dealers
- Institutional Brokers vs Retail Brokers
- Why Is This Important
  - Capitalization
  - Compliance
  - Underwriting
  - Research
  - Investment Services
- Approved List
  - Broker/Dealer Questionnaire





# WHAT DO I NEED?

- Coverage - How Many Dealers
  - Portfolio Size
  - Portfolio Complexity
- Experience
  - Education – Workshops And Conferences
  - The Process - On The Job
  - Peers
- Time Available
- Staff Available
- Information Sources



# THE SALESPERSON'S DAY

- Know Your Customers
- Know Your Firms Capabilities
- Know The Market
- Add Value
- The Day



# WHAT TO EXPECT FROM A DEALER

- Market Information And Knowledge
- Expertise Within Sector
  - Understand Each Entities Special Needs
- Good Back-Up/Operations
  - Trade Confirmation Procedure
- References
- Things To Look Out For
  - Deal Of The Day
  - They're Not Making These Anymore
  - If It's Too Good To Be True - ***IT IS***



# WHAT A DEALER NEEDS

## ● Communication

### ■ Strategy

❖ Passive/Active - Ladder/Barbell - Swaps/Credit Enhancement

### ■ Needs

❖ Sophistication/Call How Often/Type Of Information

### ■ Coverage - Strive For A Partnership

### ■ Investment Policy

## ● Fair Treatment

### ■ Feed Back - Ideas And Coverage

## ● Trust But Verify

### ■ Your Best Interest Is Theirs



# DEALING WITH YOUR DEALERS

- Broker/Dealer Compensation
- Know What You Want
  - Security Types/Cash Flows/Credit Constraints
- Buy What You Need
  - Be Consistent With Your Cash Flow Needs
  - Bond Must Fit Overall Portfolio
- The Concept Of Best Price
  - Moving Markets
  - Fair Price



# THE TRADE OFF

- Cost
- Time



This analysis should be considered in the context of the risk characteristics of the instruments being compared, which may vary as to credit quality, marketability, reinvestment risk, and other factors. Contact your investment representative, attorney, accountant or tax advisor with regard to your situation. The opinions expressed in this presentation are general in nature and not intended to provide specific advice or recommendations for any individual or association. The opinions of the author do not necessarily reflect those of Wells Fargo Institutional Securities, LLC or any other Wells Fargo entity.

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